

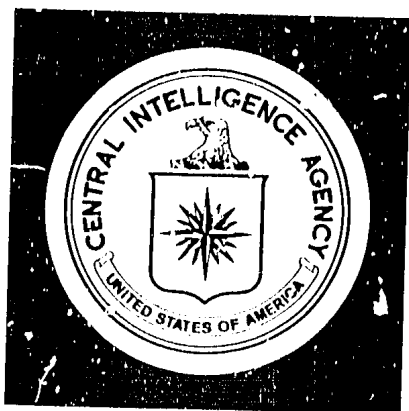
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Intelligence Report

The Economic Situation in South Vietnam, January 1975

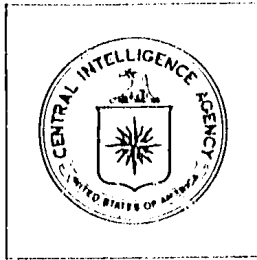
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The Economic Situation
in South Vietnam
January 1975

SUMMARY

In 1974 the South Vietnamese economy continued to suffer through a painful adjustment to the combined effects of the US military drawdown of 1969-73, substantially higher import prices, and declining real levels of US aid. The urban sector had its third successive year of severe business slump. Industrial production was off some 20% from a year earlier, almost one-fifth of the urban work force was unemployed, and real incomes among citydwellers continued to fall. After a spurt in the first quarter because of higher oil prices, depressed demand brought inflation down to about 40% for the year and an annual rate of about 10% for the last 4 months. Agricultural output rose as farmers responded to price incentives and overcame a substantial boost in fertilizer costs.

Notable economic developments in January 1975 included:

- unusually calm commodity and currency markets for the pre-Tet buying season;
- the first devaluation of the year, from 685 to 700 piasters to the dollar;
- measures taken by the government to make more credit available to the depressed business sector; and
- President Thieu's approval of a 785 billion piaster national budget for 1975.

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Note: Comments and queries regarding this report are welcomed. They may be directed to [redacted] of the Office of Economic Research, [redacted]

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DISCUSSION

The Economy in 1974¹

1. South Vietnam's economy showed mixed results in 1974. In the urban sector, the industrial slump that began in 1972 deepened. Contributing to this trend were:

- the reduced quantities and higher prices of producer imports, especially petroleum products;
- sluggish domestic consumer demand as a result of declining real per capita incomes; and
- tight business credit.

Agriculture was a bright spot with rice production up 10%, and by year's end inflationary pressures had eased substantially.

Agriculture

2. The most important economic gains during the year were in agriculture. Excellent weather, expanded use of high-yielding seeds, extensive fertilizer use, and increased paddy prices – almost double those of the previous year – led to a 1973-74 paddy harvest of 6.6 million metric tons, up 10% from the previous year. This resulted in greater domestic marketing, as the government abandoned its stringent controls and farmers were encouraged to sell more of their surpluses in traditional channels. PL-480 imports of 255,000 tons² and a shift in rice distribution in the capital away from official channels and into private markets enabled Saigon to build up and maintain its rice stocks early in the year, resulting in an average monthly level of more than 200,000 tons.

3. The 1974/75 rice crop, headed for a modest gain, may be as high as 7.0 million tons. With paddy prices at the midsummer planting time up some 35% over the beginning of the year, farmers reportedly expanded the planted area by as much as 10%. This more than offset the effects of adverse weather in some

1. Charts showing major economic indicators follow the text.

2. Total PL-480 rice imports were 300,000 tons, of which 45,000 tons were loaned to Cambodia.

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areas and of increased prices for fertilizer and other inputs.³ Fertilizer imports in 1974 were some 25% lower than the previous year because of higher world prices and reduced import funding. Returns to farmers were high enough, however, to enable them to draw on substantial in-country stocks held by merchants and speculators.

4. Another impressive agricultural gain in 1974 was in sugarcane production. Although cane still accounts for less than 2% of farm incomes, its output increased from the 300,000 to 350,000 ton range in the early 1970s to 500,000 tons in 1973 and an estimated 750,000 tons in 1974. The government is promoting sugar production to release scarce foreign exchange for other, more important imports. A major stimulus to domestic production was a ban on any further sugar imports declared in July 1974. Other incentives offered in recent years include the decontrol of sugar prices, lifting of security-related restrictions on cane-growing, and increasing credit for production and milling.

5. The production of most other crops also expanded during 1974, although some food growers faced depressed markets. Feedcorn self-sufficiency was probably reached, with production up by 10% in 1974. Peanut output also rose, permitting reduced imports of edible oils. The value of vegetable production was probably above that of 1973, but more than 2,500 farm workers on commercial vegetable farms around Dalat (Tuyen Duc Province) were unemployed because of reduced consumer demand in Saigon.

Industry

6. Industrial output continued to decline under the combined impact of reduced urban incomes, increasing import costs, and tight credit controls. A US Embassy production index for 10 Saigon industries indicated that output for the first 9 months of 1974 was more than 20% below the same period in 1973. Other indices show output at least 30% below peak 1971 levels.

7. Those industries that produce nonessential consumer goods, or that use a high proportion of imported inputs were most severely affected. In particular, the beer, softdrink, plastics, and detergent manufacturers were hard hit. Similarly, the textile industry was slowed by the accumulation of large inventories of finished

3. In September, the South Vietnamese government implemented a fertilizer subsidy scheme that should encourage greater use on the 1975-76 crop. Limited data on consumption and stocks, however, preclude judging how easily South Vietnam will cope with high import prices for fertilizer. Nonetheless, it is unlikely to be able to use stock drawdowns to meet substantial import shortages for more than one or two more years.

goods and reduced sales under the In-Country Procurement Program (ICP).⁴ Problems encountered by the ICP included funding difficulties that forced procurement to be concentrated on subsistence items, the lack of foreign markets for new product lines, and the weak financial position of many local contractors. Because of high production costs at home and reduced demand abroad, some export industries – lumber, wood products, and fishmeal, for example – operated well below capacity. Producers of more essential goods, such as cement and fish sauce, were not as seriously affected, and the production of handicraft items for export increased.

Employment

8. Large-scale and growing unemployment continued to plague urban areas in 1974 as a result of decreased industrial production and a decline in the demand for services. Data on the labor force are incomplete, but probably about 15%-20% of the urban labor force of some 3-4 million are unemployed, with many more underemployed. Toward year's end, some progress had been made in alleviating the effects of joblessness through government-sponsored work programs in Da Nang⁵ and Saigon. These programs, which are still expanding, employed some 16,000 in each of the cities at day-labor wages of 450-500 piasters. They initially concentrated on labor-intensive projects such as garbage removal, building and street cleanup, and maintenance and repair of drainage ditches. Increasing emphasis, however, is being given to longer term projects such as dikes, irrigation networks, land reclamation, and restoration of railways.

Prices

9. The consumer price index rose by 41% in 1974, a marked improvement over the 1973 increase of 65%. The sharpest increases were for kerosene (106%), gasoline (88%), and electricity (85%). Sugar, fish sauce, and beer were all up more than 70%.

10. Half of the 1974 increase occurred in the first three months of the year as high petroleum prices worked their way through the market; inflation lost most of its force thereafter. From August to year's end, prices increased at an annual rate of about 10%. In fact, price increases after August did not generally follow normal seasonal patterns, suggesting that the primary reasons for easing inflationary pressures were depressed demand and relatively tight monetary policies.

4. Under this program, US military aid is used to encourage production in South Vietnam of military-related goods such as pharmaceuticals, batteries, rations, clothing, and personal equipment in lieu of purchasing these abroad.

5. The Da Nang program began in 1972.

Monetary and Financial Factors

11. Money supply, narrowly defined as currency in circulation plus demand deposits, rose 20% over the year from 268 billion to some 322 billion piasters. Defined to include savings deposits, the increase was 35% (360 billion piasters to 485 billion). With the tendency in recent years for savings deposits to become increasingly liquid, a more accurate indicator of monetary pressure on the economy probably lies somewhere in between. Both measures of monetary growth were slightly above their respective rates of growth in 1973. In contrast to 1973, however, when bank credit to the private sector grew 70%, tight government credit policies limited the expansion of bank credit to only 20% in 1974. High interest rates and tax exemptions on treasury bills prompted banks to add some 68 billion piasters to their bill inventories rather than lend to the private sector. As a result, businessmen had considerable difficulty in obtaining financing for production, capital improvements, and unsold inventories.

12. The tight liquidity situation facing businessmen was also reflected in a narrow spread between official and black market exchange rates. The government devalued the piaster ten times in 1974 (from 550 to 685 to the US dollar), and the black market was frequently below the official rate. This was due largely to businessmen being forced to repatriate dollars -- both officially and unofficially -- to obtain piasters to finance local expenditures.

Fiscal Operations

13. The government's budgetary operations also reflected predominant concern with inflationary price trends. First, by keeping a tight rein on expenditures, the government managed to hold the deficit to 120 billion piasters⁶ -- about the same as in 1973 -- despite difficulties encountered in expanding tax revenues. Second, the government financed a much larger share of the 1974 deficit than usual through the sale of treasury bills to banks and individuals as opposed to borrowing from the National Bank of Vietnam.

14. Government expenditures rose about 40% in nominal terms to an estimated 720 billion piasters, although little if any real increase in spending occurred. Security expenditures accounted for almost one-half of the budget, and civil servant salaries and transfers to refugees and veterans took up another one-third. With 1.4 million soldiers and civil servants, payrolls constituted the largest single line item at 47% of the budget. Government workers received an average 23% pay increase at midyear, but their real wages remained below those of 1973.

6. Excluding transfers of US aid counterpart funds.

15. Revenues -- not including US aid counterpart funds -- barely kept pace with inflation by rising almost 40%, to 343 billion piasters. Real revenue increases failed to materialize because:

- many perequation taxes on imports were eliminated because world prices had risen above those of protected domestic producers;
- imports of highly taxed commodities fell;
- the urban business and industrial sectors, on which the bulk of domestic revenues depends, declined; and
- less rapid inflation toward year's end meant slower expansion of the nominal tax base.

The Foreign Sector

16. As a result of sharply higher world prices, South Vietnam's imports increased in value to some \$900 million (from \$720 million in 1973) but declined 20%-25% in volume. Most of the increase in the import bill was accounted for by petroleum and fertilizer. Despite an estimated 20% reduction in domestic fuel consumption, imports of petroleum products rose from \$85 million in 1973 to about \$150 million in 1974. Preliminary estimates of fertilizer imports, another key category, indicate that volume (about 300,000 tons) was off 25%, but the bill probably reached about \$100 million compared with \$45 million in 1973.

17. Two major food categories showed substantial changes. Rice, the biggest item in past import bills, declined in importance over the course of the year. In 1974, rice imports amounted to 255,000 tons, almost all of which arrived in the first half of the year. The sugar bill, which reached 10% of imports in past years, was down to only a million dollars despite high world prices because of increased domestic production and the government ban on further import licensing in July.

18. Other imports reflected the broad economic problems and austerity measures that prevailed throughout the year.⁷ Raw cotton imports were up more

7. In anticipation of greater pressure on its import financing account, the government laid out credit restrictions in February 1974 that limited commercial bank loans to 50% of the value of essential commodities and prohibited financing of goods on the list of nonessentials. At midyear, further licensing of nonessentials was banned. Commodities on the government's essential lists include such items as food, petroleum products, pharmaceuticals, and fertilizer, but also photographic goods and radio and television sets.

than 50% in value but off 20% in volume because of reduced textile manufacturing. Bicycle imports went up sharply in both volume and value as consumers sought to cope with high motor transport costs. On balance, however, imports of most consumer goods and foodstuffs did not change much in either value or volume. While import values for investment goods, raw materials, and construction inputs were generally equal to or greater than a year ago, many quantities declined by as much as 25%-50%, or more.

19. Exports continued to grow -- to \$75 million, from \$60 million in 1973 -- but fell well short of the \$100 million expected earlier in the year. Monthly export receipts grew rapidly in the first quarter but declined thereafter as a result of weakening world demand for South Vietnam's wood and fish exports and rising petroleum-related production costs. Sales of logs and lumber dropped precipitously in the final quarter to less than 10% of the yearly total of \$9.7 million. The effects of high fuel costs on the fishing fleet and falling Japanese consumption reduced fish and shrimp sales at midyear, although shrimp came back strongly to end the year 75% greater in volume and 85% greater in value than in 1973. Rubber exports were plagued throughout the second half by falling world prices and cost increases stemming from security deterioration.

20. Oil developments provided one positive note in the foreign sector. The increase in total foreign exchange holdings from \$154 million at the outset to \$195 million at year's end mainly reflected receipts of \$30 million in oil exploration bonuses. More important, discoveries offshore increased the prospect that South Vietnam may eventually be able to produce oil. Two wells drilled by Pecten Vietnam (a Shell subsidiary) showed the presence of oil, the second of which tested at a rate that could indicate commercial feasibility. Pecten is now drilling other confirmation wells. Mobil began drilling in one of its offshore concessions in December, and two other companies are expected to begin drilling by mid-1975. The discoveries made in 1974 should strengthen South Vietnam's position in auctioning the remainder of its offshore concessions. Substantial revenues from crude production, however, are unlikely before the end of the decade.

21. South Vietnam continued to rely heavily on foreign economic aid. The FY 1974 US aid program provided about \$650 million, some 15%-20% below the FY 1973 level in real terms. Saigon was able to attract more non-US aid than it had in 1973. Donor commitments at year's end were valued at \$185 million -- up from \$109 million in 1973 -- including substantial amounts from Japan (\$57 million), France (\$30 million), and West Germany (\$24 million). Actual

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receipts were probably on the order of \$120 million in 1974. Much of this non-US assistance is project aid, which is less suitable than commodity aid to reviving depressed elements of Vietnam's private sector.

Government Policy

22. The most significant policy development in 1974 was an October cabinet shuffle that saw the removal of four ministers directly concerned with the economy. The new cabinet installed in November featured, for the first time since 1967, a super-minister for economic affairs. The new economic czar, Nguyen Van Hao, outlined his programs, including:

- greater adjustment to lower foreign aid levels;
- more equitable distribution of income;
- greater efficiency in government enterprises;
- price stabilization;
- easier credit to stimulate private business;
- decreased imports; and
- better export promotion.

By year's end, Hao had yet to offer a strategy to achieve these objectives and had been forced to compromise on some issues in the face of political pressures.

23. During the year, the government continued to make adjustments within the structure of the extensive economic reforms of 1971 and 1972:

- the exchange rate was adjusted in frequent, small steps;
- financing restraints and outright bans were used to limit imports;
- interest rates were boosted to encourage saving and curb credit expansion; and
- the export subsidy was adjusted twice to compensate for higher production costs.

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In addition, official rice prices were raised to encourage production and reduce drawdowns from official stocks, petroleum prices were sharply boosted to reduce consumption, and a specific subsidy was implemented late in the year to encourage fertilizer application during 1975.

Persistent Problems and Prospects

24. South Vietnam carries the bulk of its economic difficulties unchanged into the new year. Tight credit policies prevent any significant turnaround in the recession. The likelihood of even lower import volumes in 1975 will continue to limit supplies of necessary producers' imports and needed improvements in industrial capital. Until industrial production increases, government work programs can only moderate urban unemployment somewhat. That so many are willing to stay in the cities and work for minimum wages in these programs indicates the difficulties in encouraging population movement back into more productive rural areas.

25. On the other hand, the economy has had continued success in several areas. Despite the high level of military activity, commodity and financial markets still reflect considerable social cohesion, and there are no signs of return to the extensive black market and smuggling of the 1960s. Weather permitting, the growth trend in agriculture is likely to continue as long as chemical supplies are adequate. Relatively buoyant rural incomes could speed the return of population to the farms. South Vietnam also enters 1975 with inflation slowed dramatically. If the economy is properly guided -- and it remains to be seen if Nguyen Van Hao and his economic ministers can do so -- there is some room for upward price adjustments that would come with expansionary policies.

* * * * *

Recent Developments

Market Conditions

26. Both commodity and currency markets were relatively calm in January. The Saigon consumer price index rose about 2% during the month, the largest increases coming in the food component -- including rice, fish sauce, fish, pork, and sugar. A surge at mid-month, which should have presaged a strong seasonal

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pre-Tet upswing in prices, moderated surprisingly at month's end. Consumers, cheered little by military events and the stagnant economy, may be forgoing the usual Tet buying spree this year or at least judiciously rationing their purchases to a few extra items of food and clothing.

27. This year's first piaster devaluation -- from 685 to 700 to the dollar on 21 January -- had no discernible effect on currency markets. The black market exchange rate remained stable at about 795-810 piasters per dollar. The sizable (15%) premium on dollars suggests that currency speculators may still be convinced the government will undertake a one-time, massive, piaster devaluation, as frequently advocated in the past by Deputy Prime Minister Hao. Gold, too, was stable at about \$200 a troy ounce.

Some Credit Easing

28. In order to alleviate the financial straits of most non-farm producers, the government acted in January to loosen credit. The National Bank reduced its regular discount rate from 22% to 18%, thereby permitting some softening in commercial rates. Credit Commercial, the largest bank in the country, reduced its lending rates from a range of 25%-30% to 22%-27%. The National Bank removed tax exemptions from treasury bills purchased by commercial banks, lowering returns on these instruments more in line with those of commercial loans.⁸

29. Initial reaction from the banks was generally that they could live with these changes, but several have petitioned the government to review the matter. It is too early to judge the reaction of the business community because there are numerous other factors, including security and market conditions, that influence investment decisions.

1975 Budget Signed

30. President Thieu signed the 1975 national budget of 785 billion piasters on 11 January. The final authorization was 40 billion piasters less than originally requested but 25% higher than last year's official appropriations.⁹ Most of the cuts were in development-related expenditures, which were slashed by 30 billion piasters to 120 billion. The decision reflected the higher priorities that the government has put on defense and on wages for civil servants.

8. In an unrelated measure, the National Bank announced at the same time that it would begin a system of compulsory deposit insurance for the banking community.

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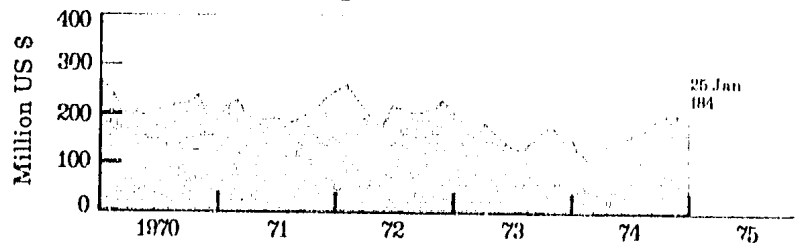
31. In addition to the official appropriations, actual expenditures are likely to be boosted by another 10%-15% by year's end. Last year, almost 100 billion piasters of additional expenditures were made for subsidy payments on rice, fertilizer, and exports. These subsidies, not included in the official budget, are likely to continue at similar or greater levels in 1975.

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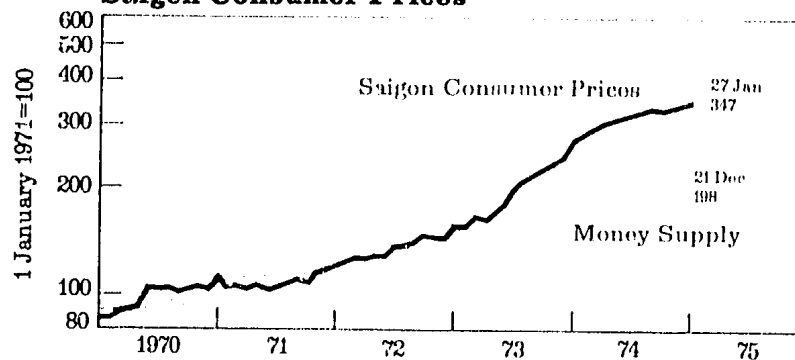
South Vietnam: Economic Indicators

Unless otherwise indicated, data are as of the end of the month.

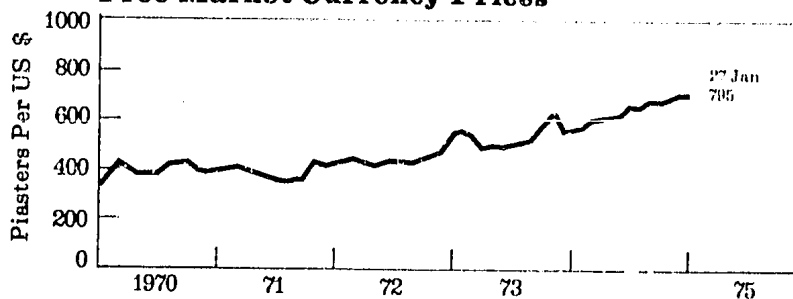
Foreign Exchange Reserves



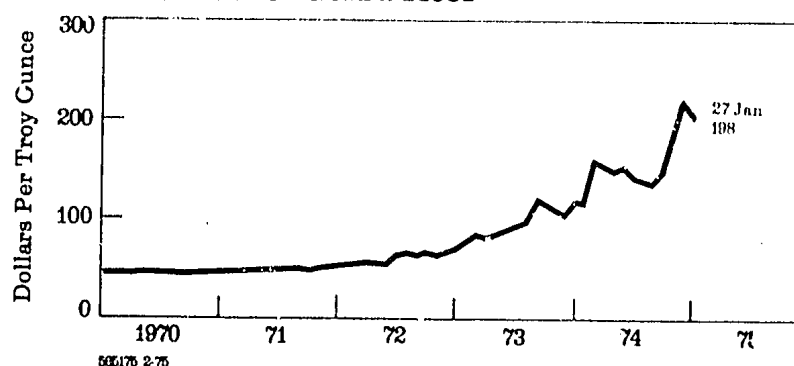
Indexes of Money Supply and Saigon Consumer Prices



Free Market Currency Prices



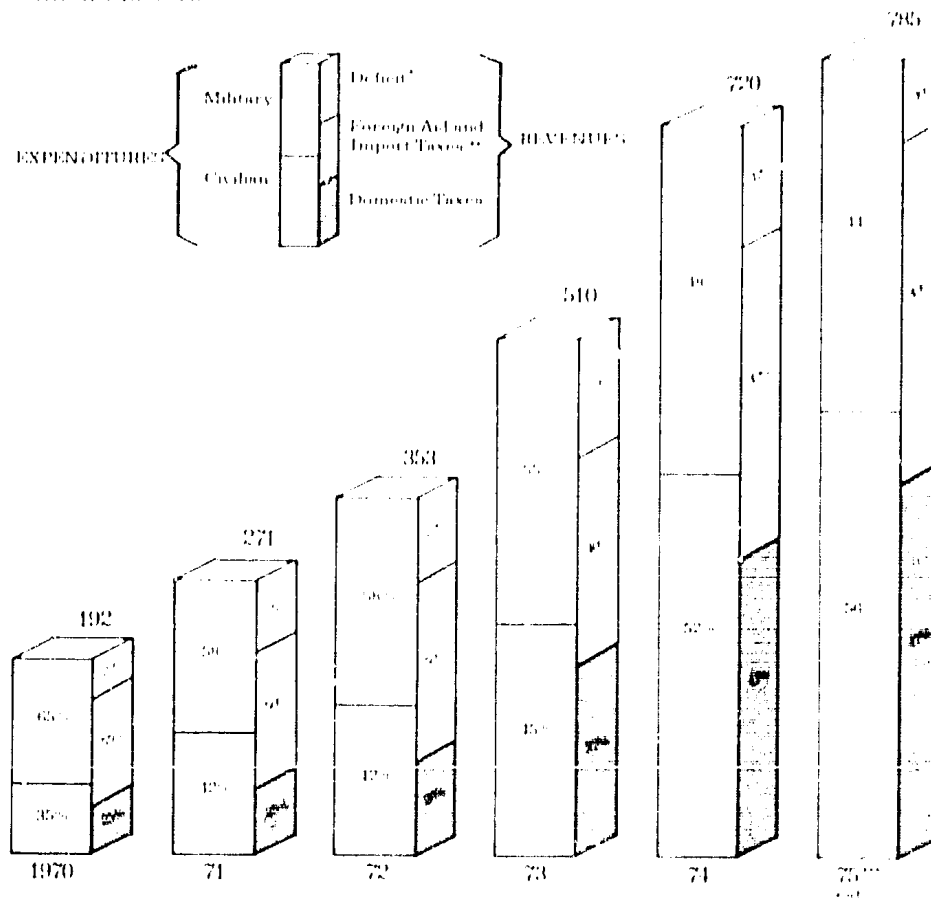
Free Market Gold Prices



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South Vietnam: Government Budget

Billion Piasters



* Residual financed primarily by borrowing from the National Bank

** Includes customs duties and other import taxes, counterpart funds generated by U.S. and other countries' import programs, and profits from foreign exchange transactions

*** Does not include rice, fertilizer, and export subsidies which may add as much as 100 billion piasters to 1975 expenditures

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